

**DEPARTMENT OF HUMAN RESOURCE MANAGEMENT
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2002**



AUDIT SUMMARY

Our audit of the Department of Human Resource Management, including the Commonwealth Health Insurance Fund, for the year ended June 30, 2002, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no internal control matters that we consider material weaknesses;
- no instances of noncompliance with applicable laws and regulations that are required to be reported under Government Auditing Standards; and
- the reserve balances for the Health Insurance and Workers' Compensation Funds continue to be below the actuarially recommended amount.

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January 2, 2003

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Human Resource Management** for the year ended June 30, 2002. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations. We also reviewed the adequacy of the reserve balances for the Health Insurance and Workers Compensation Funds.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations over the significant cycles, classes of transactions, and account balances: accounts receivable, receipts and expenses, claims payable, contract administration, and system security.

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. As discussed on pages 5-6 of this report, we found that the reserve balances for the Health Insurance and Workers Compensation Funds continues to be below the actuarially recommended amount.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on February 19, 2003.

AUDITOR OF PUBLIC ACCOUNTS

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DEPARTMENT OF HUMAN RESOURCE MANAGEMENT HIGHLIGHTS

The Department administers the health insurance plans and the workers compensation program. The Department also administers the Commonwealth's Personnel Act and provides expertise in the areas of compensation, equal employment compliance, health benefits, and human resources policy and training. The Department is also the central source for information about the Commonwealth's employment work force and provides a listing of state employment opportunities.

In fiscal year 2002, the Department of Human Resource Management administrative expenses totaled \$8.4 million. To comply with the statewide budget cuts, the Department reduced its general fund administrative budget by 11 percent or \$482,000. For fiscal year 2002, the special revenue fund was exempt from budget cuts. To absorb the budget cut, the Department improved the efficiency of administrative support services, reduced travel and registration expenses for training conferences, reduced printing and mailing costs, and reduced reliance on contractor support for computer services. Additionally, the Department eliminated funding for the Commonwealth of Virginia Campaign (CVC) oversight.

2002 ADMINISTRATIVE RECEIPTS AND EXPENSES		
Reappropriated special revenue funds		\$ 1,315,611
Receipts		
General fund appropriations	5,166,766	
Special revenue funds*	2,880,218	
Other receipts	<u>533,557</u>	
Total revenues		8,580,541
Expenses:		
Salaries and fringe benefits	5,876,749	
Contractual services	1,876,032	
Supplies and materials	96,605	
Continuous charges	420,858	
Property, plant, equipment and improvements	144,059	
Other expenses	<u>15,886</u>	
Total expenses		8,430,189
Less transfers out		<u>119,226</u>
Unexpended balance		<u>\$ 1,346,737</u>

*Special Revenue funds represents reimbursement from Health Insurance Fund for the administration of the state's health insurance benefits

For fiscal year 2003, in addition to general fund budget cuts, the Department will experience budget cuts in its special revenue funds as well. Anticipated cuts for fiscal year 2003 are 11.2 percent or \$373,970 for special revenue funds and \$665,424 or 14.9 percent for general funds.

HEALTH INSURANCE FUND HIGHLIGHTS

The Commonwealth of Virginia offers state employees and retirees, as well as Virginia localities' employees, the opportunity to participate in a group healthcare program. The program consists of several self-insured plans and commercially insured health maintenance organization (HMO) plans. The self-insured plans offered include Key Advantage, Cost Alliance, and several Medicare supplements. The number of participating HMOs drastically decreased during fiscal year 2002 from five HMOs, offering eight different health care plans, to three HMOs, offering four plans.

Administration of the Commonwealth Self-Insured Plans

The Department has contracted with Trigon and Magellan Behavior Health for the administration of the Key Advantage and Cost Alliance programs. Trigon administers the medical/surgical, dental, outpatient prescription drug, and comprehensive case management programs. Magellan administers the mental health and substance abuse program. Trigon and Magellan receive and pay provider claims, verify participant eligibility against the state's Benefit Eligibility System (BES), and serve as liaisons with health care providers and hospitals.

The Department's responsibility is to oversee the contracts. The contracts establish standards of performance for claims accuracy, processing time, and savings due to coordination of benefits with other insurance companies. The contracts require the measurement of performance standards through claims audits and impose monetary penalties for failure to meet the established standards. The Department contracts with a consultant to monitor claims paid by Trigon. The consultant currently reviews claims for eligibility requirements and produces weekly exception reports. The Department reviews the exception reports and forwards improperly paid claims to Trigon for review and correction.

Administration of the HMO Plans

Under the Health Management Organization agreements, the State Comptroller collects and remits the premiums to the HMO's that accept responsibility for payment of all claims. The Commonwealth does not assume any risk if a deficit in premiums versus claims collected was present. Therefore, the Commonwealth does not have any liability other than the disbursement of premiums withheld.

Financial Status of the Health Insurance Fund

The Commonwealth assumes all risk for the self-insured health insurance program provided to state employees and retirees. If the Health Insurance Fund (Fund) has a deficit, the Commonwealth would have responsibility for paying the outstanding claims. Annually, an actuary reviews the Fund and recommends reserves consisting of two components: incurred, but not paid (IBNP) and contingency. The IBNP portion of the reserves uses historical data and represents the amount of claims that the Fund can expect to pay subsequent to fiscal year end. The contingency reserves represent the amount of administrative costs and outstanding claims the Commonwealth would need to pay to close out the Fund.

The actuary recommended contingency reserves of \$44 million for fiscal year 2002. The actuary recommends a contingency reserve as a best practice, even if it is unlikely that the Commonwealth will permanently terminate the Fund. However, the Department believes that the contingency reserve is no longer necessary and has completely eliminated it. Nonetheless, the General Assembly has designated a sum sufficient to meet claims if the Fund ceases operations and collects no more premiums.

As shown in the table below, the asset balance for the health insurance fund has reached a deficit of \$18 million. The deficit arises from increased health care cost and collecting premiums lower than the actuarially determined rate. For fiscal year 2002, the actuary recommended IBNP reserves of \$79.6 million, an increase of 8 percent. The actuaries also projected a premium deficiency of \$27,676,192 for fiscal year 2002. The deficiency is the difference between expected fiscal year 2002 cost less premiums at fiscal year 2002 rates. Although there was an across-the-board increase in health insurance premiums for fiscal year 2002, the increase was not enough to absorb the increasing health care costs.

	2000	2001	2002
Revenue			
Premiums collected	\$458,722,739	\$496,500,263	\$530,675,276
Interest and other income	<u>4,765,162</u>	<u>5,089,484</u>	<u>3,420,668</u>
Total receipts	<u>463,487,901</u>	<u>501,589,747</u>	<u>534,095,944</u>
Expenditures			
Insurance claims	446,597,873	485,816,403	536,561,721
Contractual services	<u>28,516,643</u>	<u>34,281,133</u>	<u>32,666,395</u>
Total expenses	<u>475,114,516</u>	<u>520,097,536</u>	<u>569,228,116</u>
Income (Loss)	(11,626,615)	(18,507,789)	(35,132,172)
Beginning net asset balance	<u>46,853,284</u>	<u>35,226,669</u>	<u>16,718,881</u>
Net asset position	<u>\$ 35,226,669</u>	<u>\$ 16,718,880</u>	<u>(\$ 18,413,291)</u>

The actuary's preliminary projections of fiscal year 2003 costs indicate that premiums at fiscal year 2003 rates will likely be adequate to fund fiscal year 2003 anticipated costs.

WORKERS' COMPENSATION FUND HIGHLIGHTS

The Department of Human Resource Management assumed the responsibility for the Workers' Compensation Program from the Department of General Services on July 1, 2000. The Workers' Compensation program protects all state employees from financial loss due to lost work and wages, medical expenses, and other costs associated with a covered injury sustained in the course and scope of employment.

Managed Care Innovations has a contract to manage cost containment and claims administration and uses a subcontractor, Frank Gates Service Company, for the third-party claims administration. The Department contracts for an annual audit of the internal control procedures used by the Frank Gates Service Company when processing claims.

The Department bills agencies for insurance premiums totaling more than \$40 million annually. The fund continues to carry a deficit asset balance, which increased \$8 million from the prior year. For fiscal year 2002 the actuary recommended reserves of \$155 million. Over the years, the Department has managed to maintain a reserve of approximately \$40 million, which represents approximately one year's claim payments.

	2001	2002
Revenue		
Premiums collected	\$ 41,792,185	\$ 40,736,038
Interest /other revenue	<u>3,624,383</u>	<u>2,667,738</u>
Total receipts	<u>45,416,568</u>	<u>43,403,776</u>
Expenditures		
Insurance claims	37,751,558	45,564,412
Administrative expenses	<u>6,251,368</u>	<u>6,313,328</u>
Total expenditures	<u>44,002,926</u>	<u>51,877,740</u>
Income (Loss)	1,413,642	(8,473,964)
Beginning net asset balance	<u>(108,933,514)</u>	<u>(107,519,872)</u>
Net asset position	<u>(\$ 107,519,872)</u>	<u>(\$115,993,836)</u>

DEPARTMENT OF HUMAN RESOURCE MANAGEMENT
Richmond, Virginia

Sara Redding Wilson, Director

Mary Habel, Director
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Sue Keener, Director
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